BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 2004-6-G – ORDER NO. 2004-510

OCTOBER 19, 2004

IN RE:	South Carolina Pipeline Corporation – Annual Review of the Purchased Gas Adjustment (PGA) and Gas Purchasing Policies	)))	ORDER ON PRUDENCE, PGA, AND RELATED MATTERS

This matter is before the Public Service Commission of South Carolina ("Commission") on its annual review of the Purchased Gas Adjustments ("PGA") and Gas Purchasing Policies of South Carolina Pipeline Corporation ("SCPC" or "Company").

I. INTRODUCTION

By Commission Order No. 87-1122, dated October 5, 1987, the Commission instituted an annual review of SCPC's PGA and Gas Purchasing Policies. In this PGA proceeding, the review period is January, 2003 through December, 2003 (the "Review Period").

A Notice of Filing regarding SCPC's PGA and Gas Purchasing Policies was prepared, and the Commission's Executive Director instructed SCPC to publish the prepared Notice of Filing in newspapers of general circulation in the affected areas. SCPC complied with the Executive Director's instructions by timely publishing the

Notice of Filing and thereafter filing affidavits of publication attesting to publication as directed by the Executive Director.

The Notice of Filing established February 9, 2004, as the date by which interested persons or entities could timely file petitions to intervene or present their views in writing with the Commission. The Consumer Advocate for the State of South Carolina ("Consumer Advocate"), Nucor Steel, and the South Carolina Energy Users Committee ("SCEUC") each filed a Petition to Intervene, which the Commission granted. No other petitions to intervene or protests were filed with the Commission.

The Commission conducted a formal hearing in this matter on May 27, 2004, at 10:30 a.m. in the office of the Commission with the Honorable Mignon L. Clyburn, Chairman, presiding. Mitchell Willoughby, Esquire, and Catherine D. Taylor, Esquire, represented SCPC. Elliott F. Elam, Jr., Esquire, and Hana Pokorna-Williamson, Esquire, represented the Consumer Advocate. Scott Elliott, Esquire, represented SCEUC. F. David Butler, General Counsel, represented the Commission Staff. Nucor Steel did not appear at the hearing.

In support of its PGA and Gas Purchasing Policies, SCPC presented direct testimony from Paul V. Fant, Michael P. Wingo, Samuel L. Dozier, John S. Beier, and Thomas R. Conard. Additionally, SCPC presented rebuttal testimony from Thomas R. Conard and Dr. Julius A. Wright.

The Consumer Advocate presented direct and rebuttal testimony from Glenn A. Watkins. The Commission Staff presented direct testimony from Roy H. Barnette and Brent L. Sires. SCEU did not present any witnesses at the hearing.

II. FINDINGS OF FACT AND CONCLUSIONS OF LAW

After carefully considering the evidence, including the testimony and exhibits presented in this docket, the Commission makes the following Findings of Fact and Conclusions of Law.

A. GAS PURCHASING POLICIES AND PRACTICES

1. SCPC's gas supply portfolio consists of four gas service options: (i) wellhead gas supply; (ii) underground storage; (iii) pipeline transportation; and (iv) liquefied natural gas ("LNG"), which is available from the two interstate pipelines that serve SCPC as well as SCPC's on-system LNG facilities. (Wingo p.46, lines 11-16).

2. As of December 31, 2003, SCPC had eighteen firm wellhead supply contracts for a maximum daily quantity of 192,000 dekatherms ("Dt") per day. (Wingo p.46, lines 20-21). To further compliment its existing wellhead supply contracts, SCPC possesses the ability to make spot purchases of wellhead gas from approximately fifty-five (55) different suppliers as required to meet system needs. (Wingo p.46, line 22; p.61, lines 3-4).

3. Through careful planning and evaluation of its gas supply assets, SCPC combines its gas service options thereby creating a gas service portfolio capable of providing safe, reliable, and economical gas service to the Company's customers.

4. SCPC assembles its portfolio to meet both large swings in firm demand from day-to-day within the winter season, as well as swings over a winter season, which can range from warmer than normal to colder than normal. (Wingo p.59, lines 1-7). Importantly, this diverse and flexible portfolio of gas supply allows SCPC to meet firm

demand under varying weather conditions at a reasonable cost. (Wingo p.46, lines 17-20). By creating a well-balanced gas service portfolio, SCPC did not curtail gas service to any of its firm customers during the Review Period. (Wingo, p.62, lines 18-20).

5. In recognition of the Company's reasonable and prudent gas purchasing policies and practices, Commission Staff testified,

> [SCPC] places a high level of importance on securing reliable gas supplies and on making prudent decisions in purchasing its gas supplies to balance its customer profile and system requirements with existing supply and capacity options. *No supply problems were noted on the Company's system during the past winter period*.

(Sires p.306, lines 12-19)(emphasis added).

6. Commission Staff also testified that during the Review Period SCPC purchased its gas supplies at just and reasonable costs. (Sires p.307, lines 12-15). Commission Staff testified further, "It is Staff's observation that Pipeline continues to exhibit its capabilities to secure gas supplies in a prudent manner and at reasonable costs. My observation is that [SCPC] puts forth substantial efforts in shopping around for the lowest cost reliable supplies which are available to its system." (Sires p.307, lines 18-21).

7. At the hearing, no party submitted any evidence whatsoever suggesting that SCPC failed to maintain an adequate supply of gas, and no party contended that SCPC failed to secure its gas supplies at reasonable costs. The only evidence presented at the hearing supports a finding that SCPC's gas purchasing policies and practices were reasonable and prudent during the Review Period.

8. Therefore, based upon the clear, convincing, and uncontradicted evidence presented at the hearing, the Commission finds and concludes as a matter of law that SCPC's gas purchasing policies and practices were reasonable and prudent during the Review Period.

B. SCPC'S STORAGE ASSETS

9. To fulfill its obligation of providing safe and reliable natural gas service, SCPC acquires and manages storage assets to insure that it has sufficient reserves to meet peak day demand. (Wingo p.48, lines 14-15).

10. During the Review Period, SCPC maintained adequate gas supplies in off-system storages facilities located on Southern Natural Gas Pipeline ("Southern") and Transcontinental Pipeline ("Transco"). By contracting for adequate gas storage SCPC possesses the ability to withdraw gas from storage during periods of high demand and assist with balancing system load requirements on a daily basis. (Wingo p.48, lines 14-17).

11. In order to provide safe, reliable, and economical natural gas service to South Carolina, SCPC's management continually analyzes and considers the supply and interstate capacity aspects of its business on an on-going basis. (Fant p.18, lines 10-14). For example, in determining whether it possesses an adequate supply of gas, SCPC carefully evaluates its current gas supply, storage, transportation, and other assets already under contract. (Wingo p.57, lines 3-4). Additionally, SCPC evaluates geographical delivery limitations, maximum volumes, storage ratchets, must-take volumes, and the

cost of the various services. (Wingo p.57, lines 4-9). SCPC also carefully examines the varying weather conditions found in South Carolina. *Id*.

12. Through this evaluation process, SCPC is able to maintain sufficient reserves to meet peak day demand in all reasonably foreseeable operating conditions. Because of SCPC's careful and deliberate planning to meet peak day demand, Commission Staff testified that SCPC met the reliability expectations of its core market during the Review Period. (Sires p.323, line 24-p.324, line 1).

13. In addition to its gas supplies in storage on Southern and Transco's interstate pipeline system, SCPC operates two on-system LNG facilities both of which provide SCPC with another reliable supply of gas for its customers as needed. (Fant p.21, lines 19-20). The combined capacity of these LNG facilities provide SCPC with the ability to store up to 1,880,000 Mcf of LNG and inject the vaporized gas into SCPC's system when needed. (Fant p.21, lines 20-22; Wingo p.51, lines 18-20).

14. SCPC's on-system LNG storage significantly adds to the reliability and security of SCPC's gas supply. (Wingo p.52, lines 6-8). Moreover, Commission Staff agreed with SCPC that its on-system LNG facilities provide a reliable reserve supply of gas in emergency situations. (Sires p.305, lines 15-17).

15. SCPC presented clear, convincing, and uncontradicted evidence showing that it maintained sufficient and adequate reserves to meet peak day demand in all reasonably foreseeable operating conditions, and that SCPC's level of reserves was reasonable and prudent. Moreover, no party presented any evidence suggesting that SCPC failed to maintain sufficient and adequate reserves of gas.

16. Therefore, based upon the clear, convincing, and uncontradicted evidence presented at the hearing, the Commission finds and concludes as a matter of law that SCPC maintained sufficient and adequate reserves of gas necessary to meet peak day demand during the Review Period.

C. COMMISSION STAFF'S RECOMMENDATION

17. At the beginning of the 2003-2004 winter period (November 1, 2003) on-system LNG inventory levels at the Bushy Park and Salley facilities were at 41.73% and 90.94%, respectively. (Sires p.306, lines 1-8).

18. In response to these on-system LNG inventory levels, Commission Staff expressed concern as to whether SCPC could meet its design day expectations. (Sires p.307, lines 8-11). Consequently, Commission Staff recommended that SCPC enter the winter period each year with its on-system LNG inventory levels at or above ninety percent (90%). *Id.*

19. In order to address Commission Staff's concern fully, the Commission finds that a review of the events leading up to the beginning of the 2003-2004 winter period useful and necessary.

20. At the hearing, SCPC adequately and sufficiently explained the circumstances surrounding the storage level at the Bushy Park LNG facility. (Fant p.41, line 5-p.42, line 6). Mr. Fant testified that the Bushy Park LNG facility employed the use of a regeneration heater, which was approximately twenty (20) years old and in need of replacement. (Fant p.41, lines 11-12). SCPC scheduled the installation of a new

regeneration heater to occur during the summer months of the Review Period. (Fant p.41, lines 9-11).

21. According to SCPC's replacement plan, the new regeneration heater would be installed and operating prior to the beginning of the winter heating season. (Fant p.41, line 15). However, after the new regeneration heater was installed, SCPC discovered that its performance did not comply with the Company's specifications. (Fant p.41, lines 15-19). Rather than begin its liquefaction process with a deficient regeneration heater, SCPC decided to replace the deficient regeneration heater with a new unit. (Fant p.41, lines 19-20). This unforeseen event caused SCPC to begin its liquefaction process at the Bushy Park LNG facility about one month later than originally planned resulting in a lower than normal fill level as of November 1, 2003.

22. We find that the Company responded to this unexpected equipment failure in a prompt and prudent manner by continuing to fill its LNG storage facilities throughout November and December, 2003. By the end of December, 2003, the LNG storage level at the Bushy Park facility was at eighty-two percent (82%) – a level the Company deemed sufficient for reliable service throughout the remainder of the 2003-2004 winter season. (Fant p.42, lines 3-6).

23. The Commission understands and recognizes Commission Staff's concern that SCPC stand ready to provide reliable gas service to all of its firm customers during all weather conditions. However, in this proceeding the Company presented clear, convincing, and uncontradicted evidence showing that it acted in a reasonable and prudent manner by replacing the deficient regeneration heater with a new unit rather than

enter the 2003-2004 winter period with a regeneration heater that did not meet the Company's performance standards. Further, SCPC acted in a reasonable and prudent manner by continuing to fill its LNG facilities throughout the winter season reaching a storage level of eighty-two percent (82%). Moreover, the evidence presented at the hearing evidences that the storage level at the Bushy Park facility at the beginning of the 2003-2004 winter period did not in any way jeopardize SCPC's ability to meet its design day expectations.

24. In sum, we find that SCPC presented clear, convincing, and compelling evidence that it maintained adequate, sufficient, and reliable peaking gas supplies necessary to meet its design day requirement during the Review Period. We further find that SCPC acted in a reasonable and prudent manner when assembling its gas supply portfolio and that the record before the Commission in this proceeding shows that SCPC's PGA and gas purchasing policies and practices were reasonable and prudent during this Review Period.

25. We find that the responsibility of determining the adequacy of on-system LNG inventory levels is a utility management decision that rests ultimately with the Company and is a decision best made by SCPC. Because the Company has shown that it continually analyzes and monitors its gas supplies in a reasonable and prudent manner, it is not necessary for the Commission to issue an order instructing the Company to fill its LNG facilities to a certain level. Therefore, the Commission hereby declines to accept Commission Staff's recommendation that SCPC enter the winter period each year with its on-system LNG inventory levels at or above ninety percent (90%).

D. ADHERENCE TO ITS TARIFF

26. In this PGA proceeding, the Company provided the Commission with compelling and undisputed evidence that it properly applied its tariff and adhered to Commission orders in recovering its gas costs.

27. On behalf of SCPC, Mr. Conard testified that SCPC followed the procedure for gas cost recovery, and made all calculations in compliance with the approved tariff and Commission directives. (Conard p.178, line 3-p.179, line 7). Moreover, SCPC's recovery of gas costs was carefully made in compliance with Commission orders and the approved gas tariff. (Conard p.181, lines 4-5). Further, SCPC's monthly cost of gas calculation results in the precise recovery of actual gas costs incurred by the Company. (Conard p.181, lines 5-7).

28. Commission Staff confirmed the accuracy of SCPC's gas costs as reported to the Commission during the Review Period. (Barnette p.295, lines 12-16). Commission Staff also confirmed that SCPC complied with Commission procedures approved in prior Commission orders and that SCPC recovered no more or no less than actual gas costs allowed during Review Period. (Barnette p.295, lines 16-20).

29. No party submitted any evidence in this proceeding disputing or otherwise questioning the prudency of SCPC's gas purchases. Moreover, no party submitted any evidence showing that SCPC failed to comply with the appropriate accounting requirements of this Commission and SCPC's tariff. The only evidence presented during the proceeding supports a finding that SCPC properly recovered its gas cost in accordance with its tariff and Commission Orders.

30. Therefore, based upon the clear, convincing, and uncontradicted evidence of record, the Commission finds and concludes as a matter of law that SCPC properly recovered its gas costs in accordance with its tariff and Commission Orders. Additionally, the Commission finds and concludes as a matter of law that SCPC's monthly cost of gas calculation results in the precise recovery of actual gas costs incurred by the Company.

E. 20,000 DEKATHERMS PER DAY REQUIREMENT

31. Commission Order No. 91-1138 requires the Company to introduce into the weighted average cost of gas ("WACOG") an equivalent of 20,000 Dt per day on an annual basis of the lowest cost gas entering the Company's system. The 20,000 Dt per day requirement attempts to balance the interests of firm customers (local distribution systems that primarily serve residential and commercial customers) and industrial customers who purchase gas under the provisions of the Industrial Sales Program – Rider ("ISP-R"). (Sires p.311, lines 4-9).

32. In this proceeding, no party presented any evidence warranting a modification of the 20,000 Dt per day requirement. Commission Staff, however, recommended that the Commission continue its requirement that SCPC introduce 20,000 Dt per day of the lowest cost gas entering the Company's system into the WACOG. (Sires p.310, lines 14-18). No other witness or party took exception to Commission Staff's recommendation.

33. Based upon the record of evidence before us, the Commission hereby finds that it is reasonable and prudent to continue its requirement that SCPC assign 20,000 Dt per day of the least expensive daily delivered gas volume to the WACOG.

F. PILOT HEDGING PROGRAM

34. The market in which SCPC competes today for its gas supply is a national market that is dynamic and volatile in which extreme changes in gas prices occur in short periods of time. (Beier p.145, lines 11-15). This rapid fluctuation of prices in the natural gas market requires SCPC to constantly monitor and regularly review its gas purchasing practices in order for the Company to manage its gas costs prudently and reasonably.

35. To help stabilize the price that SCPC, and ultimately its customers, pays for natural gas SCPC implemented a hedging program in 1995, with Commission approval, in order to mitigate the impact of price volatility. (Beier p.146, lines 8-11). As a refinement to its hedging program, SCPC adopted in 1997 a statistically-based system known as the Kase HedgeModel$_{TM}$, which was developed by Kase and Company, Inc. a nationally recognized management advisory firm specializing in the energy markets. (Beier p.149, lines 7-14). SCPC's hedging program is purely a financial program and is not used by the Company for the purchase of its physical gas supplies. (Beier p. 146, lines 12-14).

36. The primary goal of SCPC's hedging program is to reduce gas price volatility through the purchase of financial instruments at the average market price over the long term. (Beier p.147, lines 14-17). In order to accomplish this goal, SCPC focuses its hedging program on two primary financial objectives: (i) lock-in low prices

which have a high probability of disappearing over the long-run; and (ii) purchase price protection when prices are rising or threatening to rise in periods of uncertainty, in order to protect against extreme high price levels. (Beier p.150, lines 5-10).

37. In order to meet these financial objectives, the Company continually analyzes market information from a variety of sources. (Beier p.150, lines 13-15). For example, SCPC receives and analyzes market information from the following sources: (i) three different daily outlooks from brokers, (ii) a weekly publication from Kase and Company, Inc., and (iii) a quarterly publication from Kase and Company, Inc. (Beier p.150, lines 14-17). SCPC also actively participates in a weekly conference call with Kase and Company, Inc. (Beier p.150, lines 20-21). Moreover, the Company regularly reviews journals such as *Gas Daily*, *Inside F.E.R.C.*, *Hart's Energy Markets*, and *AGA Storage Report*. (Beier p. 151, lines 3-5).

38. Additionally, SCANA's Risk Management Committee insures that SCPC executes the objectives and goals of the hedging program in a disciplined and consistent manner. (Beier p.151, lines 12-14). Moreover, SCANA requires audits to ensure compliance with the program. *Id*. SCPC's careful and disciplined analysis of the natural gas market demonstrates SCPC's commitment to conduct its hedging program in a reasonable and prudent manner.

39. While the hedging program's goal is to reduce price volatility and achieve the average market price for natural gas over the long term, the hedging program, nevertheless, subtracted $14,669,999 from the WACOG during the Review Period.

(Beier p.155, lines 11-12). This amount was confirmed by the Commission Staff's audit and reported in witness Sires' testimony at the hearing. (Sires p.310, lines 1-2).

40. Commission Staff also confirmed that, during the Review Period, SCPC complied with Commission Order No. 97-477, which sets forth the criteria for the Company's hedging program. (Sires p.309, lines 17-20). Moreover, Commission Staff acknowledged that SCPC continues to achieve the objective of improving cost predictability and reducing price risks by mitigating unexpected, radical price changes. (Sires p.309, lines 20-22).

41. Recognizing that the hedging program benefits SCPC and its customers, Commission Staff recommended to the Commission that it allow SCPC to continue its hedging program for another twelve-month period at the currently approved level. (Sires p.310, lines 11-13).

42. Based upon the clear, convincing, and uncontradicted evidence presented at the hearing, the Commission hereby finds and concludes that SCPC's hedging program continues to function as a prudent tool, useful in reducing the volatility associated with the price of gas. Moreover, SCPC's hedging program is benefiting and shall continue to benefit SCPC's customers over the long term. The Commission further finds and concludes that, during the Review Period, SCPC operated its hedging program in compliance with Commission Orders and that SCPC's operation of its hedging program was reasonable and prudent.

43. Therefore, based upon the evidence presented at the hearing, the Commission finds and concludes that it is in the best interest of the public to permit

SCPC to continue its hedging program at the presently approved level of up to 75% of estimated gas purchases for firm customers.

G. INDUSTRIAL SALES PROGRAM - RIDER

44. The only contested issue in this PGA proceeding arises from the Consumer Advocate's challenge to the Company's longstanding, Commission-approved ISP-R program.

45. In this PGA proceeding, the Consumer Advocate retained the services of Glenn A. Watkins requesting that he review only SCPC's ISP-R. (Watkins p.200, lines 5-13). Based upon his review, Mr. Watkins opines that the Company's sale for resale customers would have saved $11,005,000 during the Review Period had SCPC assigned its ISP-R customers and its sale for resale customers the same level of average commodity gas costs. (Watkins p.219, lines 9-13). Consequently, Mr. Watkins proposes that the Commission either eliminate the Company's ISP-R or in the alternative, require SCPC to assign all commodity costs of gas to all classes on the same basis so that all customers pay the same commodity cost of gas. (Watkins p.219, line 14-p.220, line 2).

46. While Mr. Watkins' recommendations may seem beneficial to the Company's sale for resale customers at first glance, he fails to recognize that if the Commission terminates the ISP-R or requires SCPC to assign its ISP-R customers the highest priced gas in its system that would still allow SCPC to make a competitive sale, then all of the benefits that the ISP-R currently provides SCPC, its system and all its classes of customers would be eliminated. Moreover, implementation of Mr. Watkins'

recommendations would adversely affect the sale for resale customers who conduct their own ISP-R.

47. We find that the ISP-R provides a number of benefits to SCPC, its system, and all its classes of customers, including the sale for resale customers who conduct their own ISP-R. Specifically, the ISP-R allows SCPC to:

a. Maintain service to industrial customers that would otherwise be lost to the system;

b. Generate substantial margin revenue needed to support the financial integrity of the system;

c. Create additional purchasing power and operating flexibility by allowing SCPC to purchase larger volumes of gas supply each month; and

d. Maintain a substantial pool of gas purchased for interruptible customers that can be used to serve firm customers in times of tight supply.

(Dozier p.90, line 22-p.91, line 8).

48. Most importantly, however, the ISP-R allows SCPC to earn margins from competitive industrial customers which are used primarily to off-set a significant portion of SCPC's fixed costs; costs that would otherwise be paid by SCPC's sale for resale customers. (Wright p.352, line 11-p.353, line 2).

49. SCPC earns a substantial amount of its margins from the Company's industrial customers. (Dozier p.124, lines 1-2). To illustrate this fact, the rate of return for industrial gas operations for SCPC during the Review Period was 11.28%. (Conard p.180, lines 16-17); *see also* Hearing Exhibit No.7. By comparison, the Company's rate

of return for resale gas operations was only .019%. (Conard p.180, lines 13-14); *see also* Hearing Exhibit No.7.

50. By either terminating the ISP-R or requiring SCPC to assign ISP-R customers the highest priced gas in its system that would still allow SCPC to make a competitive sale, Mr. Watkins is in essence requesting the Commission to eliminate any margins realized by SCPC and its system from the ISP-R. As a result, implementation of Mr. Watkins' recommendations would force SCPC to recover most if not all of its fixed costs from residential and commercial sale for resale customers, thus raising the cost of gas service to its sale for resale customers. (Dozier p.124, lines 1-2; Wright p.356, lines 7-9).

51. At the hearing Dr. Wright explained the significance of accepting Mr. Watkins' recommendations. Dr. Wright testified,

> [I]f there were any savings to the sale for resale customers from a reduced WACOG, these savings would likely be short lived, as the real economic impact of such a change would be a shifting of fixed costs from industrial interruptible customers to mostly residential and commercial customers. Thus, over time, the prices paid by these firm residential and commercial customers would increase in order to allow the Company to recover the costs that were no longer being recovered from the large interruptible customers.

(Wright p.368, line 20-p.369, line 5).

52. To illustrate the effect of Mr. Watkins' recommendation, SCPC presented rebuttal testimony of Mr. Conard who explained the adverse financial impact that SCPC and its sale for resale customers would experience in the event the Commission accepted Mr. Watkins' recommendation of requiring SCPC assign to ISP-R customers the highest

priced gas in its system that would still allow SCPC to make a competitive sale. *See* Hearing Exhibit No. 12.

53. Mr. Conard testified that during the Review Period, the Company's return on equity for total gas operations was only 3.36%. (Conard p.333, lines 11-13). The Company, however, is authorized by the Commission to earn a return on equity for its total gas operations in the range of 12.5% to 16.5%. (Conard p.333, lines 13-14). Accordingly, during the Review Period SCPC earned approximately nine percent (9%) less than its authorized minimum return on equity. (Conard p.333, lines 15-16).

54. According to Mr. Watkins' calculations he seeks to eliminate $11,005,000 in margin revenue from ISP-R sales. (Conard p.333, line 20-p.334, line 1); *see also* Hearing Exhibit No. 9. Assuming that Mr. Watkins' recommendation was in effect during the Review Period, the Company would have lost $11,005,000 in margin revenue thereby causing the Company's return on equity to decrease from a positive 3.36% to a negative 2.66%. (Conard p.334, lines 1-2).

55. A second illustration presented by SCPC further demonstrates the adverse financial impact of Mr. Watkins' recommendation. In order for SCPC to maintain its current return on equity at 3.36% SCPC would be required to generate an additional $11,005,000 in revenue to recover the loss of margin revenue from its industrial customers. The only manner in which SCPC can generate additional revenue to recover $11,005,000 in lost margin revenue is for SCPC to request an increase in its Commission approved rates for its sale for resale customers. Therefore, if the Commission accepted Mr. Watkins' recommendation to eliminate $11,005,000 in margin revenue, then SCPC

would be forced to recover this lost revenue from its sale for resale customers. Consequently, in order for SCPC to maintain its current return on equity at 3.36% SCPC's sale for resale customers would experience a rate increase of approximately 58.0%. (Conard p.335, lines 1-4).

56. A third and final illustration further demonstrates the adverse financial impact that SCPC's sale for resale customers would experience if the Commission accepted Mr. Watkins' alternative proposal.

57. As stated above, SCPC is authorized by the Commission to earn a return on equity for its total gas operations in the range of 12.5% to 16.5%. If SCPC sought to increase its rates to levels sufficient to achieve a return on equity for total gas operations of 12.5%, the authorized minimum return, then a rate increase from SCPC's sale for resale customers would be required in the amount of approximately $27,720,865. (Conard p.335, lines 14-18). In order to recover the lost margin revenue resulting from Mr. Watkins' recommendation and to achieve a return on equity for total gas operations of 12.5%, SCPC's sale for resale customers' rates would experience a rate increase of approximately 146.0%. (Conard p.335, lines 18-19).

58. In support of SCPC's request that the Commission continue the ISP-R without modification, Commission Staff noted the importance of retaining the ISP-R in its current form.

59. Commission Staff recognized that the ISP-R is the mechanism providing SCPC with the ability to compete with alternative fuels today. (Sires p.313, lines 8-9). Moreover, Commission Staff testified that if SCPC is to effectively compete with

alternative fuels in the industrial market, then a program like the ISP-R must exist. (Sires p.312, lines 19-20). Commission Staff also testified, "[I] would not expect that the industrial customers would favor termination of a procedure designed to retain the industrial gas load." (Sires p.313, lines 6-7). Consequently, Commission Staff recommended that the Commission authorize SCPC to continue the ISP-R without modification. (Sires p.312 lines 17-19).

60. The origin of the ISP-R stems from Commission Order No. 10,391 dated May 22, 1957, in which the Commission acknowledged the competitive nature of the industrial gas market in which SCPC participates. Specifically, the Commission authorized pipelines such as SCPC "to contract with industrial customers buying directly from the Pipeline, on terms and conditions mutually satisfactory to the respective parties." *Id*. In furtherance of this ratemaking approach, the Commission imposed maximum mark-ups, or caps, on the margins SCPC could recover from its industrial customers. *See* Commission Order No. 82-898.

61. The ISP-R as it operates today has been in existence since 1983 and was implemented in order for the Company to effectively compete against alternative fuels thereby retaining competitive industrial loads. *See* Commission Order No. 83-222.

62. When the Commission approved the ISP-R in 1983, the Commission expressly acknowledged in Order No. 83-222 its responsibility to regulate natural gas services and rates provided by the Company to benefit the public interest. Thus, the Commission considered the impact that the then proposed ISP-R would have upon all classes of customers and not just upon the participants of the ISP-R. In deciding whether

to implement the ISP-R, the Commission specifically found that all of the Company's customers would benefit directly from the ISP-R. *See* Order No. 83-222. Moreover, in Order No. 83-873 the Commission stated, "[t]he beneficial effects of the [ISP-R] should reach all categories of natural gas users in the Company's service area."

63. Further, the Commission found that, "the margin received by the Company pursuant to [the ISP-R] will help pay the fixed cost that would be paid by the Company's non-qualifying industrial gas customers and the firm resale distributor companies." Through its approval of the ISP-R, the Commission concluded that "[t]he rates for natural gas services paid by natural gas customers, other than [ISP-R] customers, of the Company will be the same or lower as that rate which would have been paid had the deliveries of natural gas to the [ISP-R] customers not been made." *See* Order No. 83-222.

64. In Docket No. 90-204-G, the Commission conducted a thorough and detailed review of SCPC's industrial margins and ratemaking and in that proceeding issued Order No. 90-729 finding as:

a. SCPC's industrial markets are in fact competitive (page 28-31);

b. Negotiated rates have worked well for SCPC and its customers in responding to volatile markets for industrial fuels (page 31);

c. SCPC's system and finances have been built around negotiated rates (page 31);

d. Negotiated rates have supported industrial development and industrial competitiveness in South Carolina (page 32-33); and

e. SCPC has managed its industrial sales programs to generate significant benefits for its sale for resale customers (page 32).

65. On appeal, the South Carolina Supreme Court reviewed the issues addressed in Commission Order No. 90-729 and ruled that the rate making approach based on negotiated margins subject to maximum mark-ups was consistent with South Carolina law. *See Nucor v. South Carolina Pub. Serv. Comm'n*, 312 S.C. 79, 439 S.E.2d 270 (1994).

66. The ISP-R is currently operating with the approval of the Commission, and has been so operating without material modification for over twenty (20) years. Since the inception of the Commission's annual PGA review of SCPC, the Commission has consistently found that the ISP-R is beneficial to SCPC, its pipeline system and all of its classes of customers. *See e.g.* Order No. 97-477; Order No. 98-298; Order No. 99-712; Order No. 2000-434; Order No. 2001-496; Order No. 2002-555A; and Order No. 2003-641.

67. During this PGA proceeding SCPC did not seek any modification to the ISP-R whatsoever and no party presented any evidence to cause the Commission to ignore over twenty (20) years of Commission precedent. Thus, as a matter of law, the ISP-R and its policies are presumptively correct. *See Hamm v. S.C. Pub. Serv. Comm'n,* 315 S.C. 119, 432 S.E.2d 454 (1993); *see also* Commission Order No. 2003-641 at p.2. Moreover, the law is clear that an administrative agency cannot act arbitrarily in failing to follow established precedent. *See 330 Concord St. Neighborhood Ass'n v. Campsen*, 309 S.C. 514, 424 S.E.2d 538 (Ct. App. 1992); *Cf. Gilstrap v. S.C. Budget & Control Bd.*, 310

S.C. 210, 423 S.E.2d 101 (1992)("Where an administrative agency has consistently applied a statute in a particular manner, its construction should not be overturned absent cogent reasons").

68. Therefore, any party who attempts to challenge SCPC's right to continue the ISP-R program bears the burden of proof in attempting to establish that this longstanding program approved by the Commission requires modification. In this PGA proceeding, we conclude as a matter of law that the Consumer Advocate has failed to meet this burden of proof.

69. The effect on SCPC and its system of Mr. Watkins' recommendations, if granted, would be severe, unwarranted, confiscatory, and unlawful. Moreover, it would be inconsistent with the logic and purpose of the ISP-R. In short, Mr. Watkins is asking this Commission to require SCPC to serve industrial customers free-of-charge. Such a result directly contravenes longstanding constitutional law reflected in the holding of *Bluefield Water Works and Improvement Co. v. Pub. Serv. Comm'n of West Virginia*, 262 U.S. 679, 43 S. Ct. 675, 67 L. Ed. 1176 (1923). In *Bluefield* the Court stated,

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return

> may be reasonable at one time and become too high or too low by changes affecting the opportunities for investment, the money market and business conditions generally.

70. The South Carolina Supreme Court adopted these standards in *Southern Bell Tel. and Tel. Co. v. S.C. Pub. Serv. Comm'n*, 270 S.C. 590, 244 S.E.2d. 278 (1978), and it is apparent that the position asserted by the Consumer Advocate violates the principles set forth in *Bluefield*, *Southern Bell*, and statutory law because SCPC is entitled to earn a reasonable return from the gas it sells to its industrial customers through the ISP-R. *See* S.C. Code Ann. § 58-5-290 (1976).

71. As it is structured today, the ISP-R provides for pricing flexibility, enhances system reliability, and contributes to system revenues and price stability. Moreover, the ISP-R program continues to provide a degree of operational and cost stability for the firm market that cannot be met through any other mechanism.

72. Based upon the clear, convincing, and uncontradicted evidence presented at the PGA proceeding, we find that the ISP-R serves as a vital and important component to SCPC's pipeline system. Moreover, the evidence presented to the Commission evidences that without the ISP-R the Company would neither effectively compete with the price of alternative fuels, nor would it earn the level of margins that it earns today. Furthermore, the public interest would not be served by eliminating the Company's ISP-R; a fact recognized by Mr. Watkins who testified on cross-examination, "I recognize the public interest may not be best served by doing away with [the ISP-R]." (Watkins p.243, line 25-p.244, line 1).

73. Therefore, based upon the substantial evidence of record, the Commission finds that the ISP-R in its currently approved form be continued without modification. Further, the Commission (i) denies the Consumer Advocate's proposal to eliminate the ISP-R and (ii) denies the Consumer Advocate's alternative proposal to require SCPC to assign all commodity costs of gas to all classes on the same basis so that all customers pay the same commodity cost of gas.

III. ORDER

NOW THEREFORE, based upon the foregoing Findings of Fact and Conclusions of Law, IT IS HEREBY ORDERED THAT:

1. SCPC's PGA gas purchasing policies and practices during the Review Period were reasonable and prudent.

2. SCPC properly adhered to the gas recovery provisions of its gas tariff and relevant Commission orders during the Review Period.

3. SCPC has managed the hedging program during the Review Period in a reasonable and prudent manner consistent with Commission orders; therefore, the hedging program shall continue at the currently approved level of up to 75% of estimated gas purchases for firm customers.

4. The Industrial Sales Program – Rider ("ISP-R") shall be continued without modification.

5. Commission Staff's recommendation that SCPC enter the winter period each year with its on-system LNG inventory levels at or above ninety percent (90%) is hereby denied.

6. The Consumer Advocate's proposal to eliminate the ISP-R is hereby denied.

7. The Consumer Advocate's proposal to require SCPC to assign all commodity costs of gas to all classes on the same basis so that all customers pay the same commodity cost of gas is hereby denied.

8. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

/s/
Randy Mitchell, Chairman

ATTEST:

/s/
G. O'Neal Hamilton, Vice Chairman

(SEAL)